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Nos. 90-1361, 90-1484

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1991

HOLYWELL CORPORATION, et al.,

Petitioners,

v.

FRED STANTON SMITH, LIQUIDATING TRUSTEE, et al.,

Respondents.

UNITED STATES OF AMERICA,

Petitioner,

v.

FRED STANTON SMITH, LIQUIDATING TRUSTEE, HOLYWELL CORPORATION, MIAMI CENTER LIMITED PARTNERSHIP, MIAMI CENTER CORPORATION, CHOPIN ASSOCIATES, THEODORE B. GOULD, and THE BANK OF NEW YORK,

Respondents.

On Writs Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

BRIEF OF RESPONDENT SHUTTS & BOWEN

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September 1991

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QUESTION PRESENTED

Whether the common-fund doctrine is applicable so as to allow an equitable lien in favor of special counsel to the trustee and against the fund preserved and created by said counsel prior to the government's claim for taxes.

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BRIEF FOR RESPONDENT SHUTTS & BOWEN

STATEMENT[1]

Respondent, Shutts & Bowen, was appointed as special counsel to the liquidating trustee to prosecute and defend certain litigation originally pending against some of the debtors in this Chapter 11 proceeding. (Pet. App. 20a). In this capacity Shutts & Bowen was awarded its fees and costs that were incurred in connection with this representation by the bankruptcy court. *Id.*

Prior to this award, however, the liquidating trustee filed an adversary proceeding in the bankruptcy court seeking, *inter alia*, declaratory judgment that the liquidating trustee was not required to either file the income tax returns, or pay the taxes that are at issue in this appeal. (Smith Br. in Opp. App. 6a). When the bankruptcy court issued its opinion that the liquidating trustee was not responsible to either file the returns, or pay the taxes, the debtors and the United States took appeals to the district court and the United States filed an emergency motion to stay the effect of the bankruptcy court's opinion. Shutts & Bowen thereafter filed a motion to intervene in the district court proceedings. (Pet. App. 20a). Both of these motions were granted by the district court on June 20, 1988. *Id.* As a result of the court's ruling on the government's emergency motion, the trustee was prohibited from disbursing any funds from the trust, including

[1] Although Shutts & Bowen does not disagree with the Statements made by petitioners, neither Statement addresses the factual predicate for Shutts & Bowen's position in this case.

respondent's fee and cost award, pending the court's decision on the government's appeal of the bankruptcy court's opinion. *Id.*

In its papers filed with the district court, Shutts & Bowen took no position on the merits, but rather argued that under the common-fund doctrine, as explained by this Court in *Boeing Co. v. Van Gemert*, 444 U.S. 472 (1980), it was entitled to receive its previously awarded fees and costs prior to any taxes that might subsequently be found to be due and owing by the trustee at least to the extent of the funds that existed in the trust attributable to the efforts of Shutts & Bowen. To this extent, Shutts & Bowen requested that the stay be lifted as to it so as to enable the trustee to pay the fee and cost award.

On July 31, 1989 the district court affirmed the bankruptcy court's opinion, and vacated the stay previously entered by it. (Pet. App. 26a). In so doing, the court found that Shutts & Bowen's requested relief thereby had become moot. *Id.* Thereafter, on August 31, 1989 appeals were taken to the circuit court, and the United States filed with that court its emergency motion to stay the district court's order. (J.A. 22). The circuit court granted this motion on September 8, 1989. (J.A. 23).

The circuit court affirmed the district court's opinion on September 18, 1990, but did not rule on the issues presented by Shutts & Bowen, presumably because, as had the district court, the circuit court found that issue moot. (Pet. App. 1a-16a).

Before this Court only the debtors moved for a stay of the circuit court's order, but that motion was denied by Justice Kennedy, thus finally enabling the trustee to pay

respondent's then three year old fee and cost award. No. A-546 (January 22, 1991).

SUMMARY OF THE ARGUMENT

Because the premise of Shutts & Bowen's original motion to intervene has become moot, in that respondent's fees have been paid, this Court could well decline to consider the merits of Shutts & Bowen's arguments. Respondent, however, feels constrained to file this brief for two reasons. First, respondent does not want its silence here to somehow be deemed a waiver of its position should this Court reverse the circuit court's decision, and the government thereafter attempt to seek reimbursement of the fees and costs awarded to Shutts & Bowen. Second, and more to the point, by letter dated February 4, 1991, the government has already indicated that it would likely seek the return of the funds received by respondent should this Court reverse the circuit court's decision. Shutts & Bowen's App. A.

As a result of this latter event, it is submitted that this Court should consider the applicability of the common-fund doctrine to the present situation. Respondent, through its prosecution and defense of numerous claims by and against the liquidating trustee, has both added to and preserved millions of dollars of the trustee's assets. It is both unreasonable and inequitable to allow creditors of the trust, including the government, to have access to those funds to satisfy their claims without first assuring that respondent has been paid for its efforts out of the

funds preserved and collected by respondent. This concept has been approved by this Court in the context of a class action recovery in the *Boeing Co. v. Van Gemert, supra,* decision, as well as by other courts in the context of bankruptcy and bankruptcy type proceedings. *In re Nucorp Energy, Inc.*, 764 F.2d 655 (9th Cir. 1985); *Abrams v. United States*, 274 F.2d 8 (8th Cir. 1960); *City of New York v. Rassner*, 127 F.2d 703 (2nd Cir. 1942); *In re S.T. Foods, Inc.*, 202 F.Supp. 37 (S.D. N.Y. 1962).

ARGUMENT

I. ASSUMING THAT THIS COURT REVERSES THE LOWER COURT'S DECISION, THE COMMON-FUND DOCTRINE IS APPLICABLE SO AS TO ALLOW AN EQUITABLE LIEN IN FAVOR OF SPECIAL COUNSEL TO THE TRUSTEE AGAINST THE FUND PRESERVED AND CREATED BY SAID COUNSEL PRIOR TO THE GOVERNMENT'S CLAIM FOR TAXES.

It is well established that bankruptcy courts are courts of equity, and thus are given fairly broad powers to insure that inequity or unfairness is not done in the administration of a matter. *Pepper v. Litton*, 308 U.S. 295 (1939); *In re Multiponics, Inc.*, 622 F.2d 709 (5th Cir. 1980). In quoting from *Pepper v. Litton, supra,* the *Multiponics* court stated,

> "The bankruptcy court has the equitable power and the duty 'to sift the circumstances surrounding any claim to see that injustice or infairness [sic] is not done in administration of the bankruptcy estate.' "

In re Multiponics, supra, at 714.

Pursuant to the terms of the plan of reorganization, the trustee was required to establish a fund in an amount reasonably necessary to pay the debtors' anticipated liability on any "disputed claims." (J.A. 48) Insofar as the instant proceedings are concerned, all litigation being handled by Shutts & Bowen involved the resolution of claims that were "disputed", and thus, subject to the plan's "reserve fund" requirement. Thus, even if the entirety of the government's claim be deemed an administrative expense and on the same level as that of Shutts & Bowen, it is respectfully submitted that, as a matter of law, Shutts & Bowen is entitled to be paid its fee in full as an equitable charge against the fund it preserved and created before any payment to the government out of that fund. *In re S.T. Foods, Inc., supra.*

In *In re S.T. Foods, Inc., supra,* the court was confronted with a situation strikingly similar to the case at bar. The government asserted, as an administrative expense, a claim for federal income and social security taxes withheld by the debtor in possession. The trustee, however, asserted that he should be paid first for all costs incurred, including attorneys' fees, which directly resulted in *creating* or *preserving* the trust.[2] In holding that the expenses claimed by the trustee were an equitable lien on the fund itself, and thus payable before the government's administrative expense claim, the court stated,

> "However, if the trustee can show that he incurred costs and expenses, including attorneys fees, which directly resulted in creating or

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[2] This claim was distinguished from his claim for the costs and expenses of general administration.

> preserving a trust fund which is not part of the assets of the estate and thus conferred a benefit on the party entitled thereto . . . [s]uch costs and expenses may under appropriate circumstances be an equitable charge on the fund in the trustee's hands. Such an equitable charge may be recognized and enforced by the bankruptcy court which has the fund under its control . . . '[I]t is well settled that bankruptcy proceedings themselves are purely equitable in their character . . . . ' It is true that these equitable powers must be exercised within the limits laid down by the Bankruptcy Act . . . . But this is not to say that the bankruptcy court in the exercise of its equitable powers may not allow a charge which in equity and good conscience should be made against a fund in the hands of one of its officers and under its control."

In re S.T. Foods. Inc., supra, at 40, 41.

In the case at bar, the confirmed Plan of reorganization provided for the payment of administrative expenses such as respondent's fees and costs (Class I), and also provided that all mechanic's lienors (Class IV) and general unsecured creditors (Class VI) would be paid in full either upon implementation of the Plan, or when the claim was resolved. (J.A. 45-47) In fact, of the disputed claims handled by respondent on behalf of the trustee, all mechanic's lienors (except for one claim that is still pending in the Florida appellate courts) and all unsecured creditors have received payment to the extent that their claim was allowed. Thus, we are now confronted with a situation where millions of dollars have been paid by the trust to hundreds of creditors who are *junior* in priority to Shutts & Bowen.

The irony here, of course, is that but for the government's claim, there apparently would not be the spector of a deficiency in the trust; and, but for the efforts of Shutts & Bowen, the government and other creditors of a lower class would not have access to an additional $3 million to $6 million from the disputed claim fund to satisfy their claims. It is precisely this irony that was addressed by the *In re S.T. Foods, Inc., supra,* court in reaching its decision.

> "If the trustee is to be denied reimbursement of costs and expenses necessarily incurred in creating or preserving funds in his hands, even though payable to others, he may be discouraged from taking steps necessary for their creation or preservation to the substantial loss and damage of the ultimate beneficiaries of the funds. On the other hand, if the trustee does not receive such reimbursement substantial benefits may gratuitously accrue to the beneficiary which it would not otherwise have received or been entitled to."

In re S.T. Foods. Inc., supra, at 41. (*See also: City of New York v. Rassner, supra,* and the discussion found in *In re S.T. Foods, Inc., supra,* concerning what occurred in *Rassner, supra,* on remand.)

This concept is not unique to bankruptcy, but has been applied by other courts when considering the issue of an attorney's entitlement to receive compensation from funds created or preserved by the attorney, but ultimately payable to others. The court in *Abrams v. United States, supra,* was asked to construe the effect of the absolute priority granted to the government under Section 3466,

Revised Statutes, 31 U.S.C., Section 191,[3] as it related to attorneys' fees incurred by an assignor under a general assignment for the benefit of the assignor's creditors. In holding that the payment of these attorneys' fees was appropriate in spite of the government's Section 3466 objection, the court stated,

> "The rationale of these holdings was said to be ' . . . the equitable principle that he who shares in a benefit should contribute a like share to the expenses incurred in realizing the benefit' . . . . Admittedly, the above noted decisions construed an act differing greatly in language and purpose from § 3466. However, they are nonetheless persuasive in setting forth what we believe to be a sound general rule. That is, that creditors must bear the expense of proceedings taken in their favor and that such expenses may include services of the attorney for the debtor if performed in furtherance of the insolvency remedy . . . In conclusion then, we believe that no construction of § 3466 is tenable which would allow the government's claim to take precedence over the amount paid here to the assignor's attorney in connection with the proceedings and entirely for the benefit of creditors."

Abrams v. United States, supra, at 13.

A similar situation is present here. Plainly, the government will benefit greatly from Shutts & Bowen's efforts should this Court reverse the circuit court's opinion. That is to say, if respondent (or anyone else for that

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[3] This section has since been renumbered as 31 U.S.C. Section 3713 and is cited by the debtors in their brief.

matter) had done nothing, there would not be some $3,000,000 to $6,000,000 in the fund originally set aside for disputed claims for the government to look to to satisfy its claim. It is not only illogical, but also inequitable to say that the attorneys who preserved and added to this fund now should be compelled to return their fees and cost award so that said award can be distributed to others.

Respondent's request is not unlike the situation presented in *In re Nucorp Energy, Inc., supra,* at 661 where the court stated,

> "Under what has become known as the 'fund' doctrine, fees and costs are awarded to an attorney for his efforts in creating, preserving, or protecting a fund or property for the benefit of the class whom he represents. The fees are paid out of the fund itself because the attorney's efforts in creating or preserving the fund have benefited others who, absent this form of compensation, 'would unfairly enjoy the benefit without having shared the cost of acquiring the benefit.' "

Nor is it unlike the situation involving an award of attorneys' fees in a class action recovery, presented to this Court in *Boeing Co. v. Van Gemert, supra,* at 478, wherein it was held,

> "The common-fund doctrine reflects the traditional practices in courts of equity . . . The doctrine rests on the perception that persons who obtain the benefit of a lawsuit without contributing to its cost are unjustly enriched at the successful litigant's expense . . . Jurisdiction over the fund involved in the litigation allows a

> court to prevent this inequity by assessing attorney's fees against the entire fund, thus spreading fees proportionately among those benefited by the suit."

A similar holding need be made in the case at bar. The equitable principles enunciated by the above courts are equally applicable here. Under the common-fund doctrine respondent is entitled to its fees and costs out of the fund created and preserved by it prior to any payment to other creditors including the government.

CONCLUSION

For the foregoing reasons Shutts & Bowen respectfully requests this Court find that Shutts & Bowen has an equitable lien on the fund it created and preserved, and that even if the government's claim is upheld, that the Court provide that Shutts & Bowen be entitled to payment prior to the government out of the fund respondent created and preserved.

Respectfully submitted,

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BY: /s/ Barbara E. Vicevich
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APPENDIX TO THE BRIEF OF RESPONDENT SHUTTS & BOWEN

APPENDIX

Letter dated February 4, 1991 to Barbara E. Vicevich from Steven Shapiro for Shirley D. Peterson, Assistant Attorney General Tax Division .App. 1

APPENDIX A

U.S. Department of Justice

Tax Division

PLEASE REPLY TO: P.O. Box 14198
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February 4, 1991

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Re: In re Holywell Corp., et al., debtors Cases No. 84-01590/91/92/93/94 (Bankr. S.D. Fla.)

Dear Ms. Vicevich:

The United States and Fred Stanton Smith, Trustee of the Miami Center Liquidating Trust, have been involved in litigation with respect to the payment of certain federal income taxes. The Trustee has prevailed in his argument that he was not required to file certain federal tax returns and pay the taxes due on those returns. See *Smith v. United States* (*In re Holywell Corp.*), 911 F.2d 1539 (11th Cir. 1990). The appellate process, however, has not been finalized since both the United States and the debtors have until March 21, 1991, to file a petition for a writ of certiorari with the United States Supreme Court.

At a hearing held on January 31, 1991, United States Bankruptcy Judge Sidney M. Weaver granted the Trustee's Motion for Order Requiring the Liquidating Trustee to Pay Claims. We are informed that Shutts & Bowen has a claim which the Trustee intends to pay pursuant to this order. Please be advised that the United States intends to file a notice of appeal to the United States District Court for the Southern District of Florida from Judge Weaver's order once it is entered.

Also, please be advised that, should the Supreme Court reverse the decision of the Eleventh Circuit, the United States would likely seek the return of funds distributed to the claimants for redistribution consistent with the trustee's responsibility for paying federal taxes.

If you have any questions, please contact trial attorney José Francisco de León of my staff at (202) 514-5040.

Sincerely yours,

Shirley D. Peterson
Assistant Attorney General
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By: /s/ Steven Shapiro
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